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MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

September 30, 2006

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MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

September 30, 2006

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APPOINTIVE OFFICIALS

George Parisot, Lottery Director

John Tarr, Lottery Assistant Director for Security

LOTTERY COMMISSION		TERM EXPIRES
Tom Keegan	Helena	January 1, 2010
Beth O'Halloran	Missoula	January 1, 2010
Robert Crippen	Butte	January 1, 2007
Wilbur Rehmann	Helena	January 1, 2009
Craig Anderson	Glendive	January 1, 2009

REPORT DISTRIBUTION

According to Section 23-7-202(9), MCA, copies of this report must be distributed to the following:

Governor – Brian Schweitzer
Director of Dept. of Administration – Janet Kelly
Legislative Auditor - Scott Seacat
President of the Senate – Jon Tester
Speaker of the House – Gary Matthews

The law also states "the President of the Senate and the Speaker of the House will determine the report distribution to each member of the appropriate committee of each house of the legislature". The President of the Senate and the Speaker of the House have requested that this report be distributed to the following committees:

HOUSE – State Administration Committee

Larry Jent, Chair
Dee Brown, Vice Chair Majority
Veronica Small-Eastman, Vice Chair Minority
Joan Andersen
Mary Caferro
Sue Dickenson
Emelie Eaton
Robin Hamilton
Gordon Hendrick
Teresa Henry
Hal Jacobson
William Jones
Gary MacLaren
Bruce Malcolm
Alan Olson
Bernie Olson

HOUSE – Business & Labor Committee

Jim Keane, Chair
Kathleen Galvin-Halcro, Vice Chair Majority
Joe McKenney, Vice Chair Minority
Elsie Arntzen
Bob Bergren
Tim Dowell
Kevin Furey
Dave Gallik
Ralph Heinert
Llew Jones
Mike Jopek
Harry Klock
Scott Mendenhall
Mike Milburn
Don Roberts
Wayne Stahl
Dan Villa
Jonathan Windy Boy

SENATE – State Administration Committee

Carolyn Squires, Chair
Joe Balyeat
Vicki Cocchiarella
Mike Cooney
Jon Ellingson
Jeff Essmann
Steve Gallus
Rick Laible
Dave Lewis
Jim Shockley
Joe Tropila

SENATE – Business & Labor Committee

Vicki Cocchiarella, Chair
Joe Balyeat
Duane Grimes
Dave Lewis
Glenn Roush
Frank Smith
Carolyn Squires
Donald Steinbeisser
Bill Tash
Jon Tester
Joe Tropila

Montana Lottery

December 2006

Montana Lottery Commission:

Fiscal year 2007 has begun with excellent overall sales resulting in a General Fund transfer that is more than double for the same time period last year, $2,714,849 compared to $1.314,628. This also compares favorably with our projected budget; this transfer represents 27.8 % of the total budget.

All products experienced increased sales over last year. Scratch sales up by 4.5% had the smallest increase. Powerball sales increased by 35.9% because of two jackpots that reached $200 million. Wild Card had one jackpot over $1 million and sales increase by 31.4%. Hot Lotto sales were up by 50.3% and it is still in the midst of a record jackpot run. Montana Cash increase by 13.7%. Overall, sales were up 25.3% over last year.

Direct game costs were consistent with sales for the quarter except for Vendor Fees, which are reduced due to the new contract. Net operating revenue as a percent of total revenue is 33.7% for the quarter compared to 29.1% last year. Total operating expenses of $849.314 for the quarter are lower than last year`s by 24.5%, because of reduced depreciation and amortization.

The Lottery continues to work toward increased product placement and sales while keeping expenses contained. Since we do not expect any substantial increased need for appropriations, preparations for the upcoming Legislative session are minor. Currently, there are no plans for other legislation relative to Lottery operations.

Sincerely,

George Parisot
Director

2525 North Montana Avenue • Helena MT 59601-0598
Phone 406-444-LUCK (5825) • Fax 406-444-5830

MONTANA LOTTERY
STATEMENT OF NET ASSETS
SEPTEMBER 30, 2006 and 2005
(UNAUDITED)

	Period Ended September 30, 2006	Period Ended September 30, 2005
ASSETS:		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 2,627,128	$ 1,055,900
Receivables (Net)	1,224,475	1,091,803
Inventories	1,184,484	812,181
Other Current Assets	23,248	24,538
TOTAL CURRENT ASSETS	5,059,335	2,984,422
NONCURRENT ASSETS		
Computer, Furniture & Equipment	411,670	5,570,754
Accumulated Depreciation	(293,229)	(5,046,732)
Software, net of Amortization	0	82,143
Multi-State Receivable	1,426,076	1,270,657
TOTAL NONCURRENT ASSETS	1,544,517	1,876,822
TOTAL ASSETS	$ 6,603,852	$ 4,861,244
LIABILITIES:		
CURRENT LIABILITIES		
Accounts Payable	$ 363,637	$ 362,002
Estimated Prize Liability	1,953,963	1,544,393
Due to Primary Government	1,412	2,704
Transfer Obligations	2,714,849	1,314,628
Deferred Revenue	109,295	209,159
Current Portion Comp. Absences	116,334	107,454
TOTAL CURRENT LIABILITIES	5,259,490	3,540,340
NONCURRENT LIABILITIES		
MUSL Prize Liability	1,264,788	1,257,803
Accrued Compensated Absences	79,574	63,101
TOTAL NONCURRENT LIABILITIES	1,344,362	1,320,904
TOTAL LIABILITIES	6,603,852	4,861,244
NET ASSETS		
Unrestricted Net Assets	0	0
TOTAL LIABILITIES AND NET ASSETS	$ 6,603,852	$ 4,861,244

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
FOR THE QUARTERS ENDED SEPTEMBER 30, 2006 and 2005
(Unaudited)

	Quarter Ended September 30, 2006	Quarter Ended September 30, 2005
OPERATING REVENUES:		
Scratch ticket revenue	$ 2,903,250	$ 2,777,808
Powerball revenue	4,787,287	3,424,639
Montana Cash revenue	993,315	873,726
Wild Card revenue	721,746	549,165
Hot Lotto revenue	894,055	594,772
Qwik Tix revenue	117,445	94,628
License, permits, and misc	980	550
Total Operating Revenues	10,418,078	8,315,288
Less Direct Game Costs:		
Scratch ticket prize expense	(1,805,801)	(1,707,312)
On-line ticket prize expense	(3,683,272)	(2,709,338)
Retailer commission	(598,490)	(504,992)
Cost of tickets sold	(191,832)	(246,534)
Vendor fees	(624,566)	(728,688)
Net Operating Revenue	3,514,117	2,418,424
OPERATING EXPENSES:		
Advertising	145,908	92,680
Advertising Production	56,481	48,740
Audit Fees	18,539	3,381
Communications	22,846	20,477
Contractual Services	19,467	46,953
Depreciation and Amortization	7,168	267,964
Administrative Service Fee	13,504	13,485
Multi-State Dues	6,077	99,663
Public Relations	31,576	4,483
Other	10,316	11,502
Personal Services	397,256	397,396
Repairs and Maintenance	3,374	1,283
Supplies and Materials	74,602	76,490
Travel	15,628	13,671
Utilities and Rent	26,572	26,723
Total Operating Expense	849,314	1,124,891
Operating Income	2,664,803	1,293,533
NONOPERATING REVENUES (EXPENSES)		
Interest earnings	50,046	21,095
Total Nonoperating Revenues(Expenses)	50,046	21,095
Income Before Operating Transfers	2,714,849	1,314,628
Operating Transfers In (Out) - General Fu	(2,714,849)	(1,314,628)
Total Operating Transfers Out	(2,714,849)	(1,314,628)
CHANGE IN NET ASSETS	0	0
Total Net Assets, Beginning of Period	0	0
TOTAL NET ASSETS, END OF PERIOD	0	$ 0

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN NET FUND ASSETS
AND RECONCILIATION OF BUDGET AND ACTUAL (BUDGETARY BASIS) TO GAAP BASIS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006
(Unaudited)

	Budget Fiscal Year July 1, 2006 - June 30, 2007	Actual Three Months Ended September 30, 2006 (Unaudited)	Actual as a Percent of Final Budget (%)
REVENUES:			
Scratch ticket revenue	$ $11,000,000	$ 2,903,250	26.39
Powerball revenue	19,500,000	4,787,287	24.55
Montana Cash revenue	3,800,000	993,315	26.14
Wild Card revenue	2,100,000	721,746	34.37
Hot Lotto revenue	2,500,000	894,055	35.76
Qwik Tix revenue	350,000	117,445	33.56
License, permits, and miscellaneous	2,000	980	49.00
Total Revenues	39,252,000	10,418,078	26.54
DIRECT GAME COSTS:			
Prizes - Scratch ticket	6,490,000	1,805,801	27.82
Prizes - Lotto games	14,021,000	3,614,893	25.78
Prizes - Qwik Tix	210,000	68,379	32.56
Retailer commissions	2,303,000	598,490	25.99
Ticket cost - scratch games	990,000	191,832	19.38
Ticket cost - vendor fees	2,286,500	624,566	27.32
Total Direct Game Costs	26,300,500	6,903,961	26.25
OPERATING EXPENSES:			
Advertising	602,750	145,908	24.21
Advertising Production	159,500	56,481	35.41
Audit Fees	35,000	18,539	52.97
Communications	83,319	22,846	27.42
Contractual Services	134,808	19,467	14.44
Administrative Service Fee	55,000	13,504	24.55
State Cost Recovery	3,143	0	0.00
Multi-State Dues	92,566	6,077	6.57
Public Relations	67,520	31,576	46.77
Other	50,712	10,316	20.34
Personal Services	1,655,639	397,256	23.99
Repairs and Maintenance	12,470	3,374	27.06
Supplies and Materials	195,125	74,602	38.23
Travel	45,448	15,628	34.39
Utilities and Rent	120,080	26,572	22.13
Equipment	38,839	0	0.00
Total Operating Expenses	3,351,919	842,146	25.12
Operating Income	9,599,581	2,671,971	27.83
NONOPERATING REVENUES (EXPENSES):			
Court Settlements	0	0	
Interest Earnings	100,000	40,724	
Security Lending Transactions		0	
Gain/(Loss) on Sale on Asset		0	
NET INCOME (BUDGETARY BASIS)	$ 9,699,581	$ 2,712,695	27.97
RECONCILIATION OF BUDGETARY/GAAP BASIS:			
1. Capitalized equipment purchases	38,839	0	0.00
2. Adjustment for compensated absences		0	
3. Adjustment for depreciation expense	(35,000)	(7,168)	20.48
4. Bad Debts		0	
5. MUSL interest earnings	50,000	9,322	18.64
Total Reconciling Items	53,839	2,154	
NET INCOME (GAAP BASIS)	$ 9,753,420	$ 2,714,849	27.83

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
ANALYSIS OF REVENUES AND EXPENSES BY PRODUCT
FOR THE QUARTER ENDED SEPTEMBER 30, 2006
(UNAUDITED)

	SCRATCH	POWERBALL	MONTANA CASH	WILD CARD	HOT LOTTO	QWIK TIX	ADMIN
REVENUES	$ 2,903,250	$ 4,787,287	$ 993,315	$ 721,746	$ 894,055	$ 117,445	$ 980
DIRECT GAME COSTS:							
Prize Expense	1,805,801	2,260,357	542,071	382,260	430,205	68,379	0
Retailer Commissions	223,159	239,132	49,625	36,050	44,677	5,847	0
Cost of Tickets Sold	191,832	0	0	0	0	0	0
Vendor Fees	172,082	284,636	60,964	44,890	55,026	6,966	0
NET OPERATING REVENUE	510,376	2,003,160	340,655	258,546	364,147	36,253	980
OPERATING EXPENSES:							
Advertising	84,157	46,225	4,526	4,525	4,526	1,008	941
Advertising Production	5,385	6,405	285	285	9	0	44,112
Audit Fees	0	0	0	0	0	0	18,539
Bad Debts	0	0	0	0	0	0	0
Communications	13,013	34	34	34	34	34	9,663
Contractual Services	0	0	0	0	0	0	19,467
Depreciation and Amortization	3,805	1,294	609	381	381	317	381
Administrative Service Fee	3,190	1,423	1,221	837	830	709	5,294
State Cost Recovery	0	0	0	0	0	0	0
Multi-State Dues	0	(4,945)	0	20,473	(1,530)	0	(7,921)
Public Relations	7,893	3,629	3,629	3,629	3,629	3,629	5,538
Other	1,518	0	0	0	0	0	8,798
Personal Services	127,650	43,065	34,657	21,273	21,013	17,776	131,822
Repairs and Maintenance	0	0	0	0	0	0	3,374
Supplies and Materials	47,468	2,040	2,085	2,040	2,040	2,583	16,347
Travel	0	0	0	0	0	0	15,629
Utilities and Rent	0	0	0	0	0	0	26,572
TOTAL OPERATING EXPENSES	294,079	99,170	47,046	53,477	30,932	26,056	298,556
OPERATING INCOME	216,297	1,903,990	293,609	205,069	333,215	10,197	(297,576)
NONOPERATING REVENUES (EXPENSES)							
Interest Earnings	0	0	0	0	0	0	50,046
TOTAL NONOPERATING REVENUES ENSES)	0	0	0	0	0	0	50,046
NET INCOME BY P	$ 216,297	$ 1,903,990	$ 293,609	$ 205,069	$ 333,215	10,197	$ (247,530)
PROFIT AS A % OF REVENUE	7.45%	39.77%	29.56%	28.41%	37.27%	8.68%	N/A

NOTE: THIS IS ONLY THREE MONTH'S ACTIVITY AND THEREFORE SHOULD NOT BE INTERPRETED TO SHOW HOW OUR PRODUCTS HAVE PERFORMED IN PAST YEARS OR WILL PERFORM IN THE FUTURE.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-7-101, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games in conjunction with other lottery states and countries, and prepare financial reports. The Montana Lottery is attached to the Montana Department of Administration for administrative purposes.

The Montana Lottery is included as an enterprise fund in the State of Montana's Comprehensive Annual Financial Report. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Montana Lottery's financial statements as a reporting agency.

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the Governmental Proprietary Fund Type. Enterprise Funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Revenue Recognition. Lottery scratch ticket sales are recorded as revenue based on the time the retailer activates the pack of tickets for sale. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales are decreased by an allowance for estimated ticket returns.

Ticket sales for lotto games, Powerball, Wild Card, Montana Cash, and Hot Lotto are recorded as revenue based on drawings. Tickets sold in advance for future drawings are recorded as deferred revenue until such time as the tickets become valid for the most current drawing. Qwik Tix revenue is recognized at the time of sale by the retailers.

Promotional Credits. The Lottery issues promotional credits to retailers to be used to distribute free tickets to players. The tickets are distributed as part of a promotion run by the retailer, e.g., "Ask for the Sale" or second chance drawings. The Lottery also directly distributes scratch tickets for promotional purposes at trade shows, for media give-aways, and during new game introductions. The tickets distributed as a result of promotional credits are reflected as a reduction in revenue. The related prize expense and ticket cost for all promotions are reclassified as an advertising expense. For the quarter ended September 30, 2006, promotional credits resulted in a revenue reduction of approximately $38,269 and an expense reclassification of approximately $27,293.

Prizes. Expenses for scratch prizes are recorded based on the predetermined prize structure for each game. Expenses for lotto and Qwik Tix prizes are recorded based on the predetermined prize structure for each individual game. No prize expense is recorded for free tickets distributed.

Unclaimed Prizes. Prizes for the lotto games must be claimed within six months after the appropriate draw date. Prizes for scratch games must be claimed within six months of the announced end of each game. Qwik Tix prizes must be claimed within six months of the sale date. The unclaimed prize amounts are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The amount of unclaimed prizes for all games is represented in the table below.

	Quarter Ended 9/30/06	Quarter Ended 9/30/05	Year To Date 9/30/06	Year To Date 9/30/05
Lotto & Qwik Tix	$172,351	$180,026	$172,351	$180,026
Scratch	10,789	25,463	10,789	25,463
TOTALS	$183,140	$205,489	$183,140	$205,489

2. SUMMARY OF ACCOUNTS

Cash and Cash Equivalents. Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool, cash on deposit with a bank and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Cash and cash equivalents consist of the following:

	September 30,	
	2006	2005
Short-term investment pool	$1,913,530	$1,007,169
Cash on deposit with State Treasurer	703,448	38,581
Cash in revolving deposit account	10,000	10,000
Petty Cash	150	150
TOTALS	$2,627,128	$1,055,900

Reference to the State of Montana's Comprehensive Annual Financial Report would identify the level of risk associated with cash and cash equivalents in the short-term investment pool and amounts retained with the State Treasurer. The bank balance of the revolving deposit account was $14,308 at September 30, 2006 and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

Receivables. Receivables include $1,348,732, representing amounts due the Lottery for tickets purchased by retailers. An allowance for doubtful accounts is reported as net of receivables and is based on historical perspective. As of September 30, 2006 the allowance is zero. An allowance for ticket returns is also included in the receivables amount. This allowance represents a reduction in receivables at September 30, 2006, for estimated ticket returns. This is an estimate based on returns received to date, as well as, an estimate of tickets unsold by retailers for games that have a public sale end date prior to October 1, 2006. The allowance for ticket returns is $148,300 at September 30, 2006. The return of vendor fees related to the allowance for returns is $24,043.

Inventories. Inventories consist of merchandise and supplies inventories. Merchandise inventory includes scratch tickets valued at $1,100,061 stored in the warehouse, at retailers prior to being activated by the retailer and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold upon activation or after game end.

Supplies inventories include ticket dispensers, premiums and point-of-sale materials. At quarter end, supplies inventories totaled $84,423. These inventories are also recorded at cost using the specific identification method.

Other Current Assets. Other current assets consist of the following:

	September 30,	
	2006	2005
Prepaid Expenses	22,974	22,788
Employee Advances	274	1,750
TOTALS	$23,248	$24,538

Transfer Obligations. The account "Transfer Obligations" is $2,714,849 payable to the General Fund at September 30, 2006.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's liability for compensated absences is detailed below.

Balance June 30, 2006	Net Leave Earned/(Used)	Balance September 30, 2006
$184,725	$11,183	$195,908

Commissions. Section 23-7-301(10), MCA, provides retailers a commission on scratch, Qwik Tix and lotto tickets or chances sold. The Lottery Commission established this commission at 5% of the face value of scratch tickets activated by the retailers and the face value of Qwik Tix and lotto tickets sold. In addition retailers can earn bonus commissions on tickets sold based on incremental sales of scratch tickets. For the quarter ended September 30, 2006 retailers earned bonus commissions of $79,828. For the quarter ended September 30, 2006 total commissions were $598,490.

3. MARKETING PRODUCTION EXPENSES

The Lottery has contracted with several vendors to provide marketing related services and materials. These services include media placement, creative design and layout, and media production. Those services and materials not included in the Advertising and Advertising Production expense categories are printing and ticket dispensers. The cost of these services and materials, included in Operating

Expenses as Contracted Services and Supplies and Materials, are detailed below for the quarter ended September 30, 2006:

Printing	$ 2,285
Ticket Dispensers	43,135
	$45,420

4. PAYMENTS TO OTHER STATE AGENCIES

The Lottery receives a variety of services and supplies and materials from other state agencies. These services and materials are detailed below for the quarter ended September 30, 2006:

Insurance	$ 4,633
Warrant Writing Services	194
Payroll Services	260
Audit Fees	6,869
Computer Fees	6,769
Printing	993
State Accounting System Support	2,784
Supplies and Materials	915
Mail Processing Fees	2,788
Telecommunications	4,139
Vehicle Rental Fees	688
Public Relations	0
Administrative Service Fees	13,503
SWCAP and SFCAP	0
Other	596
TOTAL	$45,131

5. PRIZES

Paid Prizes. Section 23-7-402, MCA states, "A minimum of 45% of the money paid for tickets or chances must be paid as prize money". Prize expense is recorded based on the predetermined prize structure percentage for each game less unclaimed prizes. For the quarter ended September 30, 2006, the prize expense of $5,489,073 is 52.69% of net Lottery ticket revenue of $10,417,098.

6. TRANSFER TO STATE GENERAL FUND

Section 23-7-402(3), MCA, states "That part of all gross revenue not used for payment of prizes, commissions, and operating expenses, together with the interest earned on the gross revenue while the gross revenue is in the enterprise fund, is net revenue. Net revenue must be transferred quarterly from the enterprise fund

established by 23-7-401 to the State General Fund." For the quarter ended September 30, 2006, the net revenue payable to the State General Fund totaled $2,714,849.

7. MULTI-STATE LOTTERY JOINT VENTURE

In November 1989 the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. Powerball, Wild Card, and Hot Lotto are the games jointly operated by the members, in which Montana presently participates. Each lottery participating in MUSL is represented on the Board of Directors.

The Multi-State Lottery Receivable with a balance of $1,426,076 as of September 30, 2006 is comprised of several reserve accounts, which are maintained by the Multi-State Lottery Association (MUSL). The balance of these reserve accounts is as follows:

Powerball Prize Reserve Account	$569,500
Powerball Set Prize Reserve Account	167,500
Powerball Unreserved Account	161,288
Wild Card Reserve Account	415,074
Hot Lotto Set Prize Reserve Account	112,714
TOTAL	$1,426,076

The Powerball Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Powerball game, assuming that no unanticipated prize claims have been paid. Interest earned on the Lottery's share of the fund, represented by the Unreserved Account, would be returned to the Lottery upon leaving MUSL. The amounts in the Unreserved Account may be used at the Board's discretion.

The Powerball Set Prize Reserve Account is used to fund prize payments for current drawings. Since the Powerball game has fixed prizes, it is often necessary to draw from this reserve to fund payment of prizes at the fixed amount. This account would be returned to the Lottery upon withdrawal from the Powerball Game.

The Lottery contributes to these reserve funds through the 50% set aside for prizes. In addition the Lottery was required to contribute for its portion of the reserve funds accumulated since the start of the Powerball game. The Lottery made this payment in full as of June 1990, through an additional 2% of drawing revenue rather than

making a lump sum payment. Payments made to this fund are considered a portion of prize expense associated with the game.

The Wild Card Reserve Account is to be used in the event of an unanticipated prize claim on the Wild Card game. This account is also administered by MUSL and would be returned to the Lottery one year after the Wild Card Product Group of Idaho, Montana, South Dakota, and North Dakota is disbanded. The Lottery contributes to this account through the 55% set aside for prizes. Payments made to this fund are considered a portion of prize expense related to the Wild Card game.

The Hot Lotto Set Prize Reserve Account is administered by MUSL and is to be used only in the event of unanticipated prize claims. Like other MUSL games the reserve amount would be returned to the Lottery one year after withdrawal from the Hot Lotto game. The Lottery contributes to the reserve through the 50% set aside for prizes. Payments made to the reserve are considered a portion of the prize expense related to the game.

8. GAMES

Currently, the Montana Lottery games are scratch ticket games, four lotto games referred to as Powerball, Montana Ca$h, Wild Card, and Hot Lotto and four instant play/instant win games referred to as Qwik Tix.

Scratch ticket games provide players the opportunity to win instantly by scratching a latex covering to reveal a prize.

The Powerball game allows players the chance to win a minimum pari-mutuel jackpot of approximately $15 million. A player must match all 6 numbers to win the jackpot; players win prizes ranging from $3 to $200,000 for matching less than all 6 numbers. Drawings are held twice weekly on Wednesday and Saturday nights. For any drawing, if no ticket matches 6 out of 6 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot. In March 2001, the Lottery added Power Play to the Powerball game. For an additional bet, the Power Play option provides non-jackpot winners the chance to multiply their prize amount by a factor of two through five.

The Montana Ca$h game allows players the chance to win a minimum pari-mutuel jackpot of $20,000. Players select 5 numbers from a field of 37 and must match at least 3 out of 5 to win a prize. Matching 3 of 5 wins $5 and 4 of 5 wins $200. The drawing is conducted twice weekly on Wednesday and Saturday nights. If no ticket matches all 5 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot.

The Wild Card game allows players the chance to win a pari-mutuel jackpot, with a guaranteed minimum of $100,000. Players select 5 numbers from a field of 31 plus

one of 16 face cards and must match all 5 numbers and the wild card to win the jackpot; players win prizes from $1 to $5,000 for matching less than all 5 numbers and/or the wild card. Drawings are held twice weekly on Wednesday and Saturday nights. If no ticket matches all 5 numbers and the wild card, the jackpot rolls over to the next drawing to create a progressive jackpot.

Hot Lotto allows players the chance to win a pari-mutuel jackpot with a guaranteed minimum of $1 million. Players choose 5 numbers from a field of 39 plus 1 Hot Ball number from a field of 19; the first 5 numbers and the Hot Ball must be matched to win the jackpot. Players can win prizes ranging from $2 to $10,000 by matching less than all 5 numbers and/or the Hot Ball. If no ticket wins the jackpot, it rolls over to the next drawing to create a progressive jackpot. Drawings are held twice weekly on Wednesday and Saturday nights.

Qwik Tix is a product line introduced by the Lottery in February 2004. There are four games, each with its own play style and prize structure. The four games are Lucky Numbers, a number match game; Hot Tac Toe, a tic tac toe grid; Jacks or Better, a poker game; and Montana Match, a match three symbols game. The Qwik Tix tickets are printed at the lotto terminal at the time of sale and can be redeemed immediately, with the maximum prize being $500. Each ticket costs $2 and consists of two plays of a single Qwik Tix game.

9. COMMITMENTS - GAMING SUPPLIER CONTRACTS

Scratch Tickets. On June 27, 2001 the Montana Lottery Commission approved the award of a one-year contract with Oberthur Gaming Technologies Corp. (Oberthur) for the provision of scratch tickets; the resulting contract was signed on August 8, 2001. The contract is for one year with the option for six additional one-year renewals. The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure.

Oberthur, as the vendor, provided a performance bond covering the contract term and an errors and omissions policy covering an ultimate net loss of $7,500,000. The Lottery may terminate this contract by providing proper notification to Oberthur.

On-line Services. On August 18, 1998, the Lottery signed a seven-year contract with Autotote Lottery Corporation to provide an on-line gaming system and associated services beginning March 28, 1999. The contract provides for payments to be made for the purchase of an on-line gaming system including terminals and software. The Lottery paid Autotote Lottery Corporation $5,025,311 for the system on April 26, 1999. Payment under the contract is also based on 8.35% of weekly Lottery sales. This contract expires on March 30, 2006.

On October 11, 2005, the Lottery signed a seven-year contract with Intralot, Inc. of Duluth, GA to provide an on-line gaming system and the associated services

beginning March 31, 2006. The contract requires Intralot to provide new terminals to all retailers with the associated software and communications. Payment under the contract is based on 5.8% of net weekly Lottery sales. The contract provides for three one-year extensions, if agreeable by both parties.

10. CONTINGENT LIABILITIES - PRIZE ANNUITIES

During fiscal year 1989, the Montana Lottery awarded four Big Spin Jackpot prizes totaling $5,000,000. The Lottery made the initial payments to the winners in the amount of $253,088 and on September 26, 1988 the Montana Lottery awarded annuities in the amount of $2,350,180 to Western National Life. Through these annuities, Western National Life makes the remaining payments to the Big Spin Jackpot winners. As of September 30, 2006 the contingent liability for future prize payments funded through the purchase of annuities was $232,500.

11. LOTTO*AMERICA/POWERBALL/TRI-WEST JACKPOT PRIZES

Jackpot prizes awarded in the Lotto*America/POWERBALL and TRI-WEST LOTTO games are funded through the purchase of U.S. Treasury Zero-Coupon Bonds purchased in the name of the Montana Lottery by MUSL. MUSL will cash the bonds each year as they mature and will wire the funds to the Lottery for payment to winners on the Anniversary date of the win.

On January 13, 1990 the Montana Lottery awarded its first Lotto*America jackpot prize totaling $1,740,000. The first annual payment of $87,000 was made on February 1, 1990. On May 9, 1990 the Lottery awarded a second Lotto*America jackpot prize of $3,000,000. The first annual payment of $150,000 was made on May 23, 1990. A third jackpot prize was awarded on February 2, 1991 for $7,360,000. The first annual payment of $368,000 was made February 15, 1991. On November 23, 1991 a fourth jackpot prize was awarded totaling $46,967,738.57. The first annual payment of $2,355,738.57 was made December 12, 1991. On April 11, 1992 a fifth jackpot prize was won totaling $2,000,000. The first annual payment of $100,000 was made on April 27, 1992.

On July 6, 1994 the Montana Lottery awarded its first Tri-West Lotto jackpot prize totaling $700,565. The first annual payment of $35,000 was made on July 26, 1994.

On July 22, 1995 the Montana Lottery awarded its first Powerball jackpot prize totaling $31,401,655.99. The first payment of $1,571,655.99 was made on August 8, 1995. On April 5, 1997 the Lottery awarded a second Powerball jackpot prize totaling $11,000,000. The first annual payment of $550,000 was awarded on April 18, 1997.

As of September 30, 2006 the combined total of future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds for Lotto*America winners was $14,423,739. The combined total of future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds for Powerball and Tri-West Lotto winners was $18,305,210.

On March 27, 1999 the Montana Lottery had a Powerball jackpot winner. The prize was $35.1 million ($19.35 million cash option). The winner chose the cash option and was paid a lump sum in June 1999.

12. LEASES

Rent. The Montana Lottery leases its office, administrative and warehouse facilities under a noncancelable lease agreement that is effective March 2002 through February 2007. The monthly lease payments through February 2007 are $7,588.

13. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the State of Montana implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*. The Lottery participates in two investment pools: the Multi-State Lottery Association (MUSL) reserve accounts and the State of Montana's Short Term Investment Pool (STIP). There are four types of risk that must be disclosed. These risks are defined below, followed by their applicability to each of the investment pools.

Credit risk is defined as the risk that an issuer of an investment will not fulfill its obligation, i.e., not make timely principal and interest payments.

Custodial credit risk is the risk that the Lottery would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party in the event of the failure of that party.

Concentration of credit is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

Multi-State Lottery Association The MUSL investment policy for prize reserve and unreserved funds states that permitted investments "include direct obligations of the United States government, perfected repurchase agreements, and obligations issued or guaranteed as to payment of principal and interest by agencies or

instrumentalities of the United States government, and mutual funds of approved investments". Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk nor concentration of credit risk per GASB Statement No. 40.

The securities are held in trust for MUSL by Mellon Trust. This large diversified institution was chosen to minimize custodial risk. It has several national offices, with the Everett, Massachusetts office handling the MUSL account. Interest rate risk is minimized by requiring that the average portfolio maturity be no more than 1.33 years and that the maximum maturity for any one security cannot exceed five years.

Short-term Investment Pool All short-term funds are held in the State's Short Term Investment Pool (STIP) administered by the Board of Investments (BOI). A summarized description of their disclosure follows and full details may be obtained by contacting the Montana Board of Investments, 2401 Colonial Drive, PO Box 200126, Helena, MT 59620-0126.

For STIP securities, BOI's policy to manage credit risk requires securities have the highest investment grade rating in the short-term category by at least one Nationally Recognized Statistical Rating Organization (NRSRO). The six NRSROs include Standard and Poors, Moody's, Duff and Phelps, Fitch, IBCA and Thompson's Bank Watch.

Per the BOI, all STIP securities are registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank. The STIP investment policy does not specifically address concentration of credit risk. However, as of June 30, 2005 there were no single issuer investments that exceeded 5% of the STIP portfolio. Per GASB Statement No. 40, interest rate disclosures are not required for STIP since STIP is a 2a-7-like pool.

Alternative accessible formats of this document will be provided upon request.